

***United States Court of Appeals
for the Second Circuit***



**APPELLEE'S REPLY
BRIEF**

Affidavit

77-6090

To be argued by
WILLIAM G. BALLAINE

United States Court of Appeals FOR THE SECOND CIRCUIT

Docket No. 77-6090

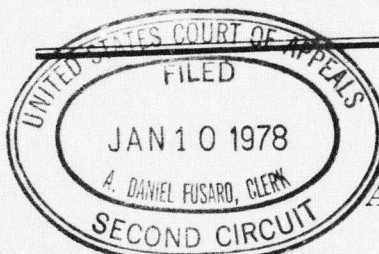
THE CONDE NAST PUBLICATIONS INC.,
*Plaintiff-Appellee and
Cross-Appellant,*

—against—

UNITED STATES OF AMERICA,
*Defendant-Appellant and
Cross-Appellee.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR DEFENDANT-APPELLANT AND CROSS-APPELLEE



ROBERT B. FISKE, JR.,
*United States Attorney for the
Southern District of New York,
Attorney for Defendant-Appellant
and Cross-Appellee.*

WILLIAM G. BALLAINE,
THOMAS E. MOSELEY,
*Assistant United States Attorneys,
Of Counsel.*



TABLE OF CONTENTS

	PAGE
Preliminary Statement	1
Responses to Certain "Facts" Asserted in Taxpayer's Reply Brief	1
 ARGUMENT:	
POINT I—The Authorities Relied upon by Taxpayer Do Not Support Its Claim	5
POINT II—Trade-Mark Law Is Relevant to the De- termination of Taxpayer's Right to Capital Gains Treatment	11
POINT III—Contrary to Taxpayer's Assertion, the Government Does Take Issue With the "Factual Determinations" Described in Taxpayer's Main Brief	15
CONCLUSION	17

TABLE OF AUTHORITIES

Cases:

<i>Commissioner v. P.G. Lake, Inc.</i> , 356 U.S. 260 (1958) ..	13
<i>Commissioner v. Wodehouse</i> , 337 U.S. 369 (1949) ..	12
<i>Conde Nast Publications, Inc. v. Vogue School of Fashion Modelling, Inc.</i> , 105 F. Supp. 325 (S.D. N.Y. 1952)	2
<i>Cory v. Commissioner</i> , 230 F.2d 941 (2d Cir.), <i>cert. denied</i> , 352 U.S. 828 (1956)	9, 10, 11
<i>Edwin K. Williams & Co. v. Edwin K. Williams & Co.—East</i> , 542 F.2d 1053 (9th Cir. 1976), <i>cert. denied</i> , 45 U.S.L.W. 3840 (U.S., June 28, 1977) ..	7
<i>Franchised Stores of New York, Inc. v. Winter</i> , 394 F.2d 664 (2d Cir. 1968)	14
<i>Gowdey's Estate v. Commissioner</i> , 307 F.2d 816 (4th Cir. 1962)	11

	PAGE
<i>Ranier Brewing Co. v. Commissioner</i> , 7 T.C. 162 (1946), <i>aff'd</i> , 165 F.2d 217 (9th Cir. 1948) ..	6, 12
<i>Redler Conveyor Co. v. Commissioner</i> , 303 F.2d 567 (1st Cir. 1962)	12
<i>Rose Marie Reid v. Commissioner</i> , 26 T.C. 622 (1956), <i>acquiesced</i> , 1956-2 Cum. Bull. 8..	6, 8, 9, 12
<i>Schmitt v. Commissioner</i> , 271 F.2d 301 (9th Cir. 1959)	12
<i>Seattle Brewing & Malting Co. v. Commissioner</i> , 6 T.C. 856 (1946), <i>aff'd</i> , 165 F.2d 216 (9th Cir. 1948)	6, 7, 8, 9, 12
<i>Ste. Pierre Smirnoff, Fls., Inc. v. Hirsch</i> , 109 F. Supp. 10 (S.D. Cal. 1952)	8, 12
<i>Switzer v. Commissioner</i> , 226 F.2d 329 (6th Cir. 1955), <i>aff'g</i> , 13 CCH Tax Ct. Mem. 840 (1954)	10
<i>United States Mineral Products Co. v. Commissioner</i> , 52 T.C. 177 (1969), <i>acquiesced</i> , 1969-2 Cum. Bull. xxv	6, 8, 9, 12
<i>Statutes:</i>	
26 U.S.C. § 1222 (3)	14
<i>Revenue Rulings:</i>	
Rev. Rul. 54-409, 1954-2 Cum. Bull. 174	6, 9, 11, 13
Rev. Rul. 60-226, 1960-1 Cum. Bull. 26	9, 10
<i>Other Authorities:</i>	
3 Callman, The Law of Unfair Competition Trademarks and Monopolies § 78.2 (3d ed. 1969)	8, 12, 13

**United States Court of Appeals
FOR THE SECOND CIRCUIT**

Docket No. 77-6090

THE CONDE NAST PUBLICATIONS INC.,
*Plaintiff-Appellee and
Cross-Appellant,*
—against—

UNITED STATES OF AMERICA,
*Defendant-Appellant and
Cross-Appellee.*

**REPLY BRIEF FOR
DEFENDANT-APPELLANT AND CROSS-APPELLEE**

Preliminary Statement

The United States of America, as defendant-appellant and cross-appellee, respectfully submits this brief in reply to the reply brief submitted by the taxpayer.*

**Responses to Certain "Facts" Asserted in Taxpayer's
Reply Brief**

(1) Taxpayer's reply brief disputes the Government's contention that there are many valuable uses of the Vogue name, insisting that the uses are but two in

*In this reply brief, the Government will adopt the definitions used in its main brief on appeal.

number—in the pattern industry and in the publication of Vogue Magazine. Txp. Reply Br. 2. Taxpayer's position, however, is belied by lawsuits in which it succeeded in preventing another company from using the Vogue name on greeting cards, on writing paper and on envelopes and a lawsuit in which taxpayer succeeded in barring a modelling school from using "Vogue" in the school name. See cases cited in Gov't Main Br. 17, n.*. These lawsuits demonstrate that as registered owner of the Vogue mark in the field of publications, taxpayer maintains an exclusive right to use the mark and name with respect to a *wide range* of goods and services in which use of the name would be associated by the public with use of the name Vogue in connection with taxpayer's publications; and this exclusive right attaches regardless of whether taxpayer is presently engaged in manufacturing these goods or providing these services. See, e.g., *Conde Nast Publications, Inc. v. Vogue School of Fashion Modelling, Inc.*, 105 F. Supp. 325, 330-31. (S.D.N.Y. 1952). Accordingly, contrary to taxpayer's claim, taxpayer has retained a number of potential valuable uses of the Vogue name quite apart from its use specifically on Vogue Magazine.

(2) Taxpayer errs in asserting that it has not retained any interest in Butterick's use of the Vogue name in the pattern field. Txp. Reply Br. 2. This assertion must be based on the assumption that the pattern business and the publishing business are entirely separate and distinct, in which event taxpayer *might* not have reason to be concerned about Butterick's use of the name in its business. See Txp. Reply Br. 18. The stipulated facts disclose, however, that the two businesses are not distinct and that taxpayer is far from indifferent as to Butterick's use of the Vogue name. Certainly taxpayer's claim of indifference would come as a surprise to Butterick's president, who in 1968, 1969 and 1970, was

obligated to have his company revise the cover format on Butterick's Vogue Pattern Books because of persistent complaints by taxpayer's president that the name "Vogue" appeared too prominently in relation to the rest of the cover logo. See JA—121-25, 130-32. An official of one of Butterick's subsidiaries would be even more surprised since he was accused by taxpayer's president of being "high-handed" for "announcing unequivocally what his plans were" concerning Butterick's use of the Vogue name in the promotion of Vogue Patterns in an Australian publication. See JA—125-29. The stipulated facts demonstrate that taxpayer retained a manifest interest in Butterick's use of the Vogue name in the pattern business simply because Butterick's use—particularly in promotional literature and advertising—overlapped substantially with taxpayer's broad retained rights to the Vogue name in the publications industry.*

(3) Taxpayer's reply brief concedes, as it must, that taxpayer obtained a stock interest in Butterick in 1961, but taxpayer characterizes this interest as "minor." Txp. Reply Br. 2. We do not accept this characterization, and suggest that it is for this Court to decide whether acquisition of at least 13.6% of Butterick's outstanding common stock constitutes a "minor" interest in that company, which in 1967 had net pattern sales of almost \$16

*It is ironic that taxpayer claims no interest in Butterick's use of the "Vogue" name in the pattern business and yet retains the right to tell Butterick that the latter cannot use the phrase "VERY EASY VERY VOGUE" when Butterick conducts advertising campaigns in a weekly publication. See JA—125-28. How can taxpayer reconcile its present claim with the fact that its president has instructed Butterick that "*the word 'Vogue' may never be used alone*" [emphasis in the original] by Butterick in its business? See JA—126.

million and in 1968 had net sales exceeding \$18 million.
See JA—157.*

(4) Taxpayer's reply brief states that the parties "indicated those sections of the License Agreement in which it could be argued that Nast 'retained an interest' in Butterick's use of the mark 'Vogue' . . ." Txp. Reply Br. 18. This statement is incorrect. The Government simply stipulated, at taxpayer's request, that the primary purpose of certain sections of the License was to preserve the value of the Vogue name. *See* JA—21. This is a far cry from conceding that these specified sections were the only sections evidencing a retained interest by taxpayer. In addition, taxpayer's reply brief states that, as respects those same specified sections of the License, we stipulated that taxpayer never exercised any interest in Butterick's use of the mark. Txp. Reply Br. 18. To the contrary, the Government only conceded that there was no "direct evidence" on this issue "other than as indicated in this Stipulation." *See* JA—21. As we have noted both in this brief and in our main brief, the stipulated record does, in fact, contain evidence of taxpayer's exercise of an interest in Butterick's use of the mark.**

* In our briefs below the Government did not draw the District Court's attention to taxpayer's acquisition of Butterick's stock. This fact, however, is plainly part of the stipulated record submitted to the District Court for a decision on the merits. JA—37-39, 50-51. In this regard, we are constrained to object to taxpayer's request that this Court take "judicial notice" of the ownership rights of "Butterick's management." Txp. Reply Br. 2, n.3. We have no idea where the 58% ownership figure comes from, and it was not part of the stipulated facts below.

** Taxpayer's reply brief also emphasizes our stipulation that certain sections of the License were designed primarily to preserve the value and reputation of the "Vogue" trade name. Txp. Reply Br. 18. This stipulation, of course, is not a concession that

[Footnote continued on following page]

ARGUMENT

POINT I

The authorities relied upon by taxpayer do not support its claim

Taxpayer's reply brief is important both for what it argues and what it does not argue.* Taxpayer, for example, chooses not to dispute our analysis of the Dairy Queen cases. Taxpayer's failure to do so is significant. In our main brief, we demonstrated that with perhaps one exception, the Dairy Queen cases declined to give capital gains treatment to indeterminate royalty payments and thus these decisions were not necessarily at odds with the Government's present position. See Gov't Main Br. 18-21. The District Court obviously had reached a contrary result, since it relied heavily on these decisions to support its conclusion that at least some of taxpayer's indeterminate royalty payments were entitled to capital gains treatment. Taxpayer's failure to discuss the Dairy Queen cases suggests that it too believes that taxpayer's claim must rest on a sturdier legal foundation than is provided by these inconsistent and confusing decisions.**

taxpayer took no interest in Butterick's use of the name. As we have argued on this appeal, taxpayer's substantial interest in preserving the value of the Vogue name necessarily embraces a substantial interest in and concern for the manner in which this name is used by Butterick in the pattern industry.

* Among other matters, taxpayer does not dispute or discuss our analysis of substantive trade-mark law. Taxpayer's decision to elide trade-mark law is discussed *infra* at Point II.

** Taxpayer's reply brief emphasizes that the Government "has not quarreled" with the District Court's comparison of the Dairy Queen agreements with taxpayer's License. See Txp. Reply Br. 20-21. Obviously, however, the District Court's analysis is meaningless if the District Court improperly construed the legal

[Footnote continued on following page]

Shunning the Dairy Queen cases, taxpayer relies instead on *Seattle Brewing & Malting Co. v. Commissioner*, 6 T.C. 856 (1946), *aff'd*, 165 F.2d 216 (9th Cir. 1948) and the companion case of *Ranier Brewing Co. v. Commissioner*, 7 T.C. 162 (1946), *aff'd*, 165 F.2d 217 (9th Cir. 1948), on *Rose Marie Reid v. Commissioner*, 26 T.C. 622 (1956), *acquiesced*, 1956-2 Cum. Bull. 8, on *United States Mineral Products Co. v. Commissioner*, 52 T.C. 177 (1969), *acquiesced*, 1969-2 Cum. Bull. xxv, and lastly on Revenue Ruling 54-409, 1954-2 Cum. Bull. 174. Txp. Reply Br. 5-6, 7-15, 22. Not one of these authorities, however, offers the legal support that taxpayer attributes to them.

Taxpayer quotes extensively from *Seattle Brewing* (Txp. Reply Br. 8-10), yet never mentions that the trade names there were considered to have been sold *only after* the purchaser had exercised an option which terminated a requirement that it make royalty payments based on use of these trade names. *See* Gov't Main Br. 22. Once the option was exercised, it was the *Government* which argued that the transfer more nearly resembled a sale. The legal significance of the purchaser's exercise of this option terminating further royalty payments is demonstrated by a portion of the Tax Court's analysis which taxpayer has chosen not to quote:

After the payment of \$1,000,000 the rights of the parties were very different, as were also their obligations. Rainier no longer had the right to call the contract breached and take over the trade name for failure to pay the price. . . . Prior to the exercise of the option petitioner's right, although designated perpetual in the contract, was not in

import of the Dairy Queen cases. Taxpayer cannot seriously claim the benefits of the District Court's factual analysis at the same time as it utterly fails to justify the District Court's legal reliance on the Dairy Queen cases.

fact perpetual. It was perpetuated so long as the petitioner continued to pay royalties and was subject to being forfeited by a breach as provided in the contract. After the exercise of the option the right became perpetual in a real sense. Thereafter there was no further payment to be made and the forfeiture clause became inoperative. The exclusive right to use the trade name in the designated territory became perpetual and the liability of having it revoked by the happening of a subsequent condition no longer existed in a real sense. Provisions such as the maintenance of quality, advertising, and the purchase of malt were for the mutual benefit of both parties, and the agreement to protect the licensee against infringement was no different than one to protect title. The most important provision in the contract was the payment of the price, and, when payment had been made in full, provisions for the mutual benefit of the parties became of relative minor importance.

Seattle Brewing & Malting Co. v. Commissioner, supra, 6 T.C. at 868.*

* Even if we put aside the royalty payments factor, the case for finding only a license here is stronger than in *Seattle Brewing*. In *Seattle Brewing*, the transferor retained the right to use the transferred name on non-alcoholic beverages, but there is no indication whether the transferor ever used this retained right. See Gov't Main Br. 22, n.**. Here taxpayer retained and is exercising a valuable right to use the Vogue name and in doing so, taxpayer is periodically restricting Butterick's use of the Vogue name even within the pattern industry. See, *supra* at 2-3; Gov't Main Br. 7, 16; JA—121-32. In addition, taxpayer's own treatment of the royalties and the fact that the License was modified to strengthen further taxpayer's retained rights constitute further evidence, not present in *Seattle Brewing*, militating against taxpayer's claim. See Gov't Main Br. 27-29. See also *Edwin K. Williams & Co. v. Edwin K. Williams & Co.-East*, 542 F.2d 1053 1059 (9th Cir. 1976), *cert. denied*, 45 U.S.L.W. 3840 (U.S., June 28, 1977) (licenses, not sales agreements, are renewed).

Here, taxpayer has continued to retain the right to terminate the License should taxpayer fail to pay all royalties due. Thus, under the *Seattle Brewing* analysis, Butterick's right "was not in fact perpetual," * precluding the finding of a sale.

Taxpayer's reliance on *Rose Marie Reid* and *United States Mineral Products Co.* is equally unavailing. As our main brief notes, in both cases the transferor had parted with *all* valuable uses of the trade name in issue. Gov't Main Br. 21-22. The only limitation in those cases was geographical. Trade-mark law has long since recognized that a transfer of all uses in a limited geographical area may qualify as a sale. *See, e.g., Ste. Pierre Smirnoff, Fls., Inc. v. Hirsch*, 109 F. Supp. 10 (S.D. Cal. 1952); 3 Callman, *The Law of Unfair Competition Trade-marks and Monopolies* § 78.2 at 460 (3d ed. 1969). As we have pointed out, however, trade-mark law does *not* permit a holder to sell outright a limited use of its registered mark when the transferee's use would be associated by the public with the transferor's retained use of the same name in the same area. *See* Gov't Main Br. 15-17. Accordingly, the transfers in *Rose Marie Reid* and *United States Mineral Products Co.* were critically different from the limited use transfer involved here.**

* The teaching of *Seattle Brewing* contradicts taxpayer's statement in its reply brief that Butterick has been granted "perpetual" rights and that taxpayer's rights in the pattern business were "eliminated." *See* Txp. Reply Br. 16, 17. *See also* Gov't Main Br. 5, setting forth conditions under which Butterick's rights must terminate and revert to taxpayer.

** The argument for capital gains treatment in both *Rose Marie Reid* and *United States Mineral Products Co.* is stronger than taxpayer's for other reasons as well. Neither case indicates whether the parties' agreements had any comprehensive quality control provisions, restrictions on the transferee's right to assign its rights or provisions giving the transferor control over infringe-

[Footnote continued on following page]

Finally, taxpayer's reliance on Revenue Ruling 54-409, 1954-2 Cum. Bull. 174 also is misplaced. In that Ruling, the Internal Revenue Service advised that trade-marks and names "*may be divided into separately salable fractions [emphasis added].*" This simply means that in tax law, as in trade-mark law, certain transfers of less than all rights to a mark may nonetheless constitute a sale, as was the case in *Seattle Brewing*. Thus, as just indicated, the transfer of all uses to a mark, but only within a limited geographical area, may constitute a sale under both trade-mark law and tax law. See, *supra* at 8. The Ruling, of course, does not mean that *all* fractional trade-mark transfers will qualify as sales.

Apart from its misplaced reliance on three Tax Court decisions and a Revenue Ruling, taxpayer's reply brief incorrectly insists that this Court's holding in *Cory v. Commissioner*, 230 F.2d 941 (2d Cir.), *cert. denied*, 352 U.S. 828 (1956) is irrelevant to the present trade-mark transfer case. Txp. Reply Br. 3-5. Taxpayer argues that *Cory* was "negated" by Revenue Ruling 60-226, 1960-1 Cum. Bull. 26, an argument which is fatally flawed.

The Government does not contend that taxpayer's transfer was a license *solely* because it transferred less than all rights in exchange for indeterminate royalty pay-

ment actions. These provisions however, clearly appear in the present case and weigh against taxpayer's claim. See Gov't Main Br. 24-26. In addition, in neither of those cases had the transferor for years treated all royalties as ordinary income or extracted from the transferee even greater restrictions after the agreement had been in force for a number of years, as is the case here. See Gov't Main Br. 27-29. Finally, in *Rose Marie Reid* the transferee became registered owner of the transferred name, see Gov't Main Br. 22, n.*, and it is possible that the transferee in *United States v. Mineral Products Co.* also had the ability to record its rights to the transferred name. We argued in our main brief that the fact that the Vogue mark is registered only in taxpayer's name is probative of a license, rather than a sale. See Gov't Main Br. 14, 27.

ments. We do contend that given the dispositive weight accorded these two factors by this Court in *Cory*, they must be given serious weight in the present case.* Thus, in our main brief we argued that the two factors which were found in *Cory* to be sufficient to preclude a sale, together with *other* factors found in the present case, are sufficient to defeat taxpayer's position. This view is perfectly consistent with Revenue Ruling 60-226, which expressly states that limited transfers involving royalties may also involve the retention of other rights which would preclude a sale; as illustrations of such transfers which do not qualify as sales, Revenue Ruling 60-226 cites to cases set forth in an earlier ruling, including *Switzer v. Commissioner*, 226 F.2d 329 (6th Cir. 1955), *aff'g*, 13 CCH Tax Ct. Mem. 840 (1954), a decision which strongly supports the Government's position in this action.**

* At a minimum, this Court's holding in *Cory* should be pertinent where, as here, the particular type of limited use transferred would not, under trade-mark law, qualify as a sale. See Gov't Main Br. 14-17.

** In *Switzer*, the Sixth Circuit Court of Appeals affirmed a Tax Court decision finding that no sale of a patent interest had taken place primarily because (1) the terminology of the transfer document denoted a license (2) the parties thereafter discussed who would conduct patent litigation (3) the transferor had previously reported royalties as ordinary income and (4) the transferred interest was assignable only to parties who succeeded to the transferee's business. *Id.*, 226 F.2d at 331. All these factors (and more) are present in the case at bar.

Switzer, it should be noted, contradicts taxpayer's claim that taxpayer's treatment of the royalty payments as ordinary income is "neutral" on whether the transfer effected a sale. See Txp. Reply Br. 7. Obviously, when a taxpayer is unsophisticated, it is harder to draw a reasonable inference from the tax treatment he gives royalty payments. But when taxpayer is a major business enterprise, it is reasonable to infer, absent an alternative explanation, that the taxpayer was fully aware of the capital gains provisions, but concluded that the transaction did not qualify for capital gains treatment. See Gov't Main Br. 27-28, 30.

Taxpayer asks this Court to ignore *Cory* on the theory that tax law concerning copyright and trade-mark transfers have differed sharply, noting that for many years the Internal Revenue Service declined to recognize that copyrights could be divided into saleable fractions. See Txp. Reply Br. 4-5. The answer to this argument lies in taxpayer's own brief. In Revenue Ruling 54-409, 1954-2 Cum. Bull. 174, the Internal Revenue Service indicated that both copyrights and trade-marks "may" be divisible for tax purposes into separate saleable fractions. This Ruling was issued two years before the *Cory* decision. Moreover, nothing in this Court's decision contradicts the earlier Ruling, since *Cory* was based upon the coexistence of a limited transfer and indeterminate royalty payments. See Gov't Main Br. 13.

POINT II

Trade-mark law is relevant to the determination of taxpayer's right to capital gains treatment

Taxpayer would like this Court to believe that trade-mark law has no bearing whatsoever on the Court's resolution of this tax dispute. Txp. Reply Br. 1, 5-6. Notwithstanding taxpayer's position, substantive trade-mark law is relevant to disposition of taxpayer's present claim.

Case law discloses that substantive legal principles governing the transfer of an intangible asset do not suddenly lose their significance simply because the transfer is viewed in a tax setting. Thus, for example, many courts have sought instruction from substantive law governing patent or copyright transfers when considering the proper tax treatment to be accorded sums received by a taxpayer as consideration for the sale of a trade name, patent or copyright interest. See, e.g., *Gowdey's Estate v. Commissioner*, 307 F.2d 816 (4th Cir. 1962),

Redler Conveyor Co. v. Commissioner, 303 F.2d 567 (1st Cir. 1962), and *Schmitt v. Commissioner*, 271 F.2d 301 (9th Cir. 1959) citing *Waterman v. Mackenzie*, 138 U.S. 252 (1891), a case involving a patent infringement; see also *Commissioner v. Wodehouse*, 337 U.S. 369, 401-25 (1949) (Frankfurter, J., dissenting) in which Justice Frankfurter's analysis draws extensively from substantive copyright law, *id.*, 337 U.S. at 418-25. Indeed, in *Seattle Brewing & Malting Co. v. Commissioner*, *supra*, 6 T.C. 856 (1946), one of the tax cases cited by taxpayer, the Tax Court relied in part upon a non-tax case involving a patent transfer, *id.*, 6 T.C. at 869, 871, and a non-tax case concerning a trade-mark transfer, *id.*, 6 T.C. at 872, 873.

Taxpayer suggests that in the past the Government has unsuccessfully urged the application of trade-mark law to capital gains cases. Txp. Reply Br. 5-6, 22. However, the cases taxpayer points to do not support this claim. Two of the cases cited by taxpayer, *Rose Marie Reid v. Commissioner*, *supra*, 26 T.C. 622; and *United States Mineral Products Co. v. Commissioner*, *supra*, 52 T.C. 177, involved transfers of all trade-mark rights, subject only to geographical limitations. As previously discussed, these two decisions do not contradict trade-mark law at all. See, e.g., *Ste. Pierre Smirnoff, Fls., Inc. v. Hirsch*, *supra*, 109 F. Supp. at 12; 3 Callman, *supra*, § 78.2 at 460. In the remaining case cited by taxpayer, *Seattle Brewing & Malting Co. v. Commissioner*, *supra*, 6 T.C. 856 (plus its companion case of *Ranier Brewing Co. v. Commissioner*, *supra*, 7 T.C. 162), it was the Government which argued that once royalty payments were terminated, the taxpayer's license became a sale. Accordingly, we do not see how taxpayer can cite *Seattle Brewing* as an example of the Government's unsuccessful attempt to apply trade-mark law. Moreover, at least one trade-mark authority has cited *Seattle Brewing* in his treatise, contradicting taxpayer's implication that this Tax Court decision cannot

be squared with substantive trade-mark law. See 3 Callman, *supra*, § 78.2 at 460.

Finally, taxpayer's reply brief suggests that substantive trade-mark principles are at odds with Revenue Ruling 54-409, 1954-2 Cum. Bull. 174, discussed earlier in this brief. As we already have pointed out, however, this Ruling is not incompatible with the trade-mark principles relied upon here. See, *supra* at 8, 9.

The Government has argued on this appeal that under principles of trade-mark law, taxpayer could not have sold the Vogue mark outright to Butterick for use in the pattern business because Butterick and taxpayer thereafter used the name on goods likely to be associated with a common source. Gov't Main Br. 15-17. In its reply brief, taxpayer does not dispute that it and Butterick have used the Vogue name on goods likely to be associated with a common source;* nor does taxpayer dispute the Government's analysis of substantive trade-mark principles. Given the Supreme Court's advice that the capital gains provisions must be narrowly construed so as to protect the revenue against artful devices, *Commissioner v. P.G. Lake, Inc.*, 356 U.S. 260, 265 (1958), great weight should be given to the teaching of substantive trade-mark law in this case. It would be illogical to conclude that even though the capital gains provisions are not to be liberally construed, taxpayer may claim the tax benefits of such treatment on the basis of the

* Taxpayer is hardly in a position to dispute this fact. One of its own letters to Butterick states that if the name Vogue were used alone by Butterick in connection with its pattern promotions, it would be associated by the public with Vogue Magazine. JA—125-27. Indeed, as noted earlier, taxpayer has flatly instructed Butterick that "the simplest way to explain the rules of the game is to say that *the word 'Vogue' may never be used alone*, for if so used it means 'Vogue Magazine' and nothing else [emphasis in the original]". JA—126.

claim that it "sold" a capital asset under 26 U.S.C. § 1222(3), without any regard to the fact that under substantive trade-mark law, the transfer cannot qualify as a sale at all.

The Government does not claim that substantive trade-mark law outside the tax setting is always controlling in determining whether a transfer is a license or a sale for tax purposes. We claim simply that this law may be instructive in deciding the true nature of taxpayer's transfer. Where, as here, trade-mark law outside the tax setting appears to preclude a sale and taxpayer has executed an agreement which bears the form of a license, contains comprehensive quality control provisions* and includes royalty payments based on use of the transferred interest, taxpayer should not be able to claim the substantial benefits of capital gains treatment. *See Gov't Main Br., Point IA.* Alternatively, the numerous factors weighing against taxpayer's present claim—factors in addition to those just described—should be considered together with the lessons of substantive trade-mark law; and when all these factors and lessons are considered in the aggregate, they compel a conclusion consistent with that reached under substantive trade-mark law—taxpayer only granted a license of the Vogue name. *See Gov't Main Br., Point IB.*

* We note that taxpayer's reply brief quotes the District Court's conclusion that taxpayer cannot terminate the License if Butterick does not comply with these quality control provisions. *See Txp. Reply Br. 20-21* Under common law principles, however, if Butterick fails to abide by these provisions taxpayer appears to have the right to seek appropriate legal relief. *See, e.g., Franchised Stores of New York, Inc. v. Winter*, 394 F.2d 664, 668-69 (2d Cir. 1968)

POINT III

Contrary to taxpayer's assertion, the Government does take issue with the "factual determinations" described in taxpayer's main brief

Taxpayer's reply brief states that the Government does not take issue with the seven "factual determinations" described by taxpayer at pages 5-6 of its main brief. Txp. Reply Br. 16, n.8. Quite the contrary, as respects these seven so-called factual determinations,* our main brief made the following points:

1. The restrictions on Butterick's use of the Vogue mark are not, as the District Court believed, limited to restrictions on quality control, termination, and restraints on availability. *See* Txp. Main Br. 5. Other restrictions included taxpayer's retention of control over infringement actions (*see* Gov't Main Br. 26) and its retained authority to limit Butterick's use of the Vogue name whenever taxpayer felt the use would be confused by the public with taxpayer's retained use of the same name (*see* Gov't Main Br. 16-17, 29). Moreover, resolution of this action requires consideration not only of restrictions, but also of interests retained by taxpayer (*see* Gov't Main Br. 11, 12-13, 24-26, 27, 29) together with other factors indicating the true legal relationship between taxpayer and Butterick (*see* Gov't Main Br. 14-17, 26-27 and 27-30). The District Court gave little or no consideration to these other relevant matters.

2. As respects the District Court's finding that the License was intended primarily to protect the Vogue name for taxpayer's use in connection with Vogue Magazine (*see* Txp. Main Br. 5), our main brief pointed out that

* Some of these "factual determinations" are in fact conclusions of law or mixed fact-law conclusions.

the License had to include a broader purpose—the protection of taxpayer's valuable rights to the registered Vogue mark. *See* Gov't Main Br. 15 and n.**; 29; *see also* JA-21. The quality control provisions, for example, had to be included in order to protect *all* rights embraced by taxpayer's registered mark (including Butterick's limited right to use the Vogue name), since failure to include these provisions might well result in cancellation of taxpayer's trade-mark rights. *See* Gov't Main Br. 15 and n.**.

3. The District Court found that the restraints on Butterick's use of the Vogue name were less substantial than those in most of the Dairy Queen cases. *See* Txp. Main Br. 5. But our main brief indicated that, apart from ignoring factors other than contractual restraints, the District Court completely overlooked taxpayer's retention of control over infringement actions. *See* Gov't Main Br. 26. Moreover, we demonstrated that the District Court misunderstood the import of the Dairy Queen cases, apparently ignoring the fact that with perhaps one exception, the Dairy Queen cases did *not* grant capital gains treatment to indeterminate royalty payments. *See* Gov't Main Br. 18-21.

4. As respects the District Court's view that taxpayer's ongoing "involvement" in Butterick's business consisted only of an occasional letter (*see* Txp. Main Br. 5), our main brief disclosed that these "occasional letters" evidenced substantial power over Butterick's use of the Vogue name. Gov't Main Br. 7, 16, 29 and n.*; *see also supra* at 2-3. We also emphasized that the proper focus is on what rights were retained by taxpayer under the License, not what rights were exercised. *See* Gov't Main Br. 29-30.

5. The District Court concluded that taxpayer's grant to Butterick was "absolute," *i.e.* a sale. Txp. Main Br. 5-6. But the entire thrust of our main brief was to demonstrate the error of this conclusion.

6. Contrary to the District Court's conclusion (*see* Txp. Main Br. 6), our main brief disclosed that taxpayer's grant of only a limited use is a significant factor which, together with other factors reflected in the record, defeats taxpayer's claim to capital gains treatment. Gov't Main Br. 12-18, 22-23, 24, 30-31.

7. Contrary to the District Court's conclusion (*see* Txp. Main Br. 6), we argued throughout our main brief that *none* of the royalty payments received by taxpayer are entitled to capital gains treatment.

CONCLUSION

Taxpayer confuses the pertinent issues on this appeal by persistently arguing that the critical question is whether taxpayer exercised continuing operating interest in Butterick's business.* *See* Txp. Reply Br. 2, 6-7. Taxpayer also makes the hollow claim that its position "will not lead to an imagined raid on the fisc," and that the Government has submitted no valid public policy

*In the face of taxpayer's somewhat confusing argument as to the appropriate standard for determining whether a sale or license has been made (*see* Txp. Reply Br. 6-7), the Government still maintains that it has correctly described the pertinent standard. *See* Gov't Main Br. 11 and n.*. It makes no sense to say, as taxpayer seems to do, that the nature of a transaction entered into in 1961 cannot be determined until some years later, after the transferor has indicated the extent to which it is exercising a continuing operating interest in the transferee's business. We submit that the issue of the transferor's retention of an operational interest is relevant only insofar as it bears on the parties' interpretation of the transferor's retained rights under the controlling instrument. Of course, there are other factors which also properly bear on the parties' interpretation, as we discussed in our main brief. *See* Gov't Main Br. 26-30. Taxpayer chooses to ignore these other factors.

reason supporting denial of taxpayer's claim.* *See* Txp. Reply Br. 22. All of taxpayer's contentions, however, should be rejected. The facts in this action, viewed in the light of pertinent law, demonstrate that taxpayer's present claim cannot be sustained.

Accordingly, the judgment and amended judgment of the United States District Court should be vacated and this matter remanded to the District Court with instructions to enter a judgment dismissing taxpayer's complaint, with prejudice.

Dated: New York, New York
January 10, 1978

Respectfully submitted,

ROBERT B. FISKE, JR.,
*United States Attorney for the
Southern District of New York,
Attorney for Defendant-Appellant
and Cross-Appellee.*

WILLIAM G. BALLAINE,
THOMAS E. MOSELEY,
*Assistant United States Attorneys,
Of Counsel.*

* Perhaps recognizing the strength of the Government's public policy argument (*see* Govt. Main Brief 30 and n.*), taxpayer suggests that "it can be safely assumed that the Government will, and probably has, rejected any claim of Butterick that payments to Nast qualify as a cost-of-business deduction." Txp. Reply Br. 22. The point, however, is that if taxpayer had made an outright sale in 1961 Butterick *never* should have received deductions. Moreover, where, as here, taxpayer waits many years before claiming the right to a different tax treatment than it had previously, voluntarily adopted, the Government faces the difficult task of trying to gather evidence of long-past events in order to determine what treatment is, in fact, proper. Under the circumstances, taxpayer should not be able to change its position after many years and *also* claim its previous tax treatment is of *no* relevance.

AFFIDAVIT OF MAILING

State of New York)
County of New York) ss

Marian J. Bryant being duly sworn,
deposes and says that s he is employed in the Office of the
United States Attorney for the Southern District of New York.

That on the
two copies
10th day of January 19 78 she served ~~a copy~~ of the
within Reply Brief for Defendant-Appellant and Cross-Appellee

by placing the same in a properly postpaid franked envelope addressed:

Sabin, Bermant & Blau
350 Madison Avenue
New York, New York 10017

And deponent further says s he sealed the said envelope and placed the same in the mail chute drop for mailing in the United States Courthouse Annex, One St. Andrews Plaza, Borough of Manhattan, City of New York.

Sworn to before me this

Marion L Buxton

10th day of January, 19 ⁷⁸

Leaph Lee

